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February

Business Conditions

A review by the **Federal Reserve Bank of Chicago**



page

contents

- | | |
|----|--|
| 5 | Business loan expansion turned around |
| 6 | Interest rates show softness |
| 8 | State-local spending, aid to business? |
| 11 | Midwest department store sales lead nation |
| 13 | Industrial expansion in hard goods |
| 2 | The Trend of Business |

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THE Trend OF BUSINESS

Rising unemployment and the drive to work down bulky inventories took the spotlight of business attention in December and January. Slowing demand had become evident in mid-summer. As a result industrial production began to ease downward, and layoffs in a number of lines followed.

Business inventories rose continuously in 1953 until October, although total business sales had reached a peak rate in July. In the final months of the build-up much of the rise was involuntary as delivery was accepted on orders placed in a time of rosier sales projections. This lag in the adjustment of production to demand duplicates experience in previous periods in which activity crossed the hump from expansion to decline.

The rise in total book value of inventories between January and October of last year was 4.9 billion dollars or over 6 per cent. When the slide began, it was fairly steep—900 million from the end of September to the end of November—approximately as swift as the gain in preceding months. There is considerable evidence that the liquidation continued into 1954.

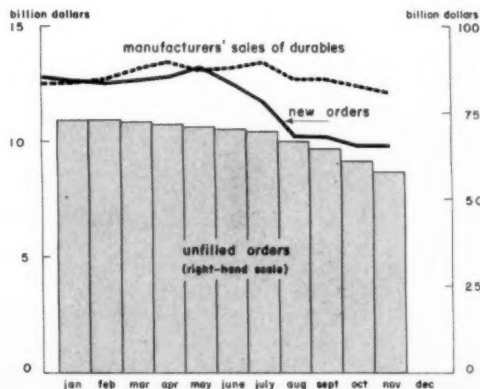
Manufacturers account for about 60 per cent of all business inventories, and it was likely that they cut their holdings appreciably in December and January since: (1) Manufacturers' new orders continued to run about 10 per cent below sales from August through November; (2) The initial reductions in the manufacturers' inventories were largely concentrated in purchased materials rather than goods-in-process or finished goods; (3) Advance information indicates that hard goods manufacturers had made little progress in working off heavy stocks through November

because of the longer lead time needed for scheduling this type of production; (4) Steel executives reported a slow trend of new orders in January and remarked publicly about the lack of orders from their largest customer, the automobile industry.

Aside from the desire to reduce inventories relative to sales, there were other considerations that induced both trade and manufacturing firms to review their inventory positions. Buyers were beginning to look for additional direct or indirect price concessions from their suppliers. Even more important, the ease of obtaining additional goods resulting from the improved supply situation made possible a lower inventory investment with less risk of losing sales because of inadequate stocks.

The danger in any downward movement in inventories lies in the possibility that it will

Order backlogs slide as sales of durable goods producers outrun new business



become self-generating. The loss of jobs and income which occurs as a result of attempts to reduce inventories at all levels tends to lower retail purchases by consumers. This process in turn may influence decisions relating to equipment purchases and new construction. Inventory building had added to sales during most of 1953. Since September this stimulus has given way to the opposite, depressing influence—the satisfaction of demand from stocks of goods produced in the past.

The inventory turnabout is looked upon with favor in some quarters. This development is said to be part of a desirable adjustment from the overblown activity levels of the first half of 1953. Optimists expect the downward movement to reverse itself in the months ahead with the result that total activity will stabilize or turn upward. The excellent level of department store sales in early January is cited to show the continuing high rate of consumer spending. Some expansive influence upon consumer purchases is expected to result from January tax cuts, and comfort is found also in the expectation that Government spending, business expenditures for new plant and equipment, and construction outlays will be only moderately lower in 1954.

It is significant, however, that factory employment declined from 17.3 to 16.4 million between August and December and apparently continued to slide in January. Moreover, the average work week and therefore average weekly pay was falling. By December a 4 billion dollar or more decline in the annual rate of factory pay was estimated to have occurred since the summer peak.

Insured unemployment had risen to 1.7 million nationally by December 26—about double the figure for September. Such a gain was not a seasonal development. About one-half million additional covered workers were listed on the compensation rolls in the two weeks ending January 9. In large part the sharp rise after year-end was a seasonal development as trade and service firms reduced Christmas help and construction activity fell to its yearly low. In addition, however, factory

Insured unemployment up sharply in second half of 1953

	December 27, 1952	June 27, 1953	December 26, 1953
	(In thousands)		
United States	1,005	852	1,711
Illinois	43	53	92
Indiana	16	16	47
Iowa	5	4	15
Michigan	26	20	93
Wisconsin	14	10	42

SOURCE: U. S. Department of Labor.

and railroad layoffs were still swelling the totals as production and shipments of goods continued to slide.

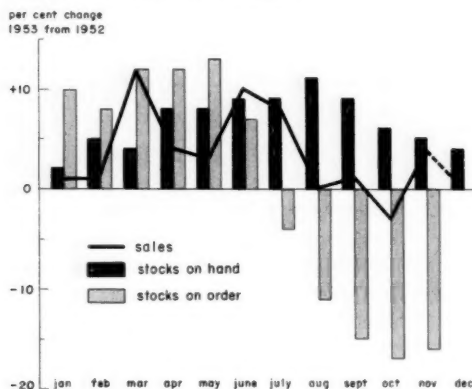
Business failures, steel scrap prices, and freight carloadings—traditional barometers of business health—were not reassuring. Business failures in late 1953 were the highest since early 1950. Scrap prices in Chicago in January were the lowest since 1949, and carloadings, which in late 1953 had been running about 10 per cent below 1952, continued to lag year-ago figures by the same amount in the early weeks of this year.

President Eisenhower in a report to the American people early in January stated that, "the Federal Government should be prepared at all times—ready at a moment's notice—to use every proper means to sustain the basic prosperity of our people." He pledged that, "Every legitimate means available . . . is being used and will continue to be used as necessary." In the State of the Union message he listed such specific stimulants to activity as liberalized treatment of depreciation allowances, easier credit for home building and modernization, and public works laid well in advance.

Tax cuts were noticed by many wage earners in their first pay check of the new year. The 10 per cent reduction in personal income taxes, however, was offset for most persons of moderate means by an increase in the social security rate from 1½ to 2 per cent.

Department store trade in the Christmas season failed to equal the nation's 1952 record. Physical volume may have been maintained,

Stocks at District department stores remain above year-ago despite order cutbacks



however, as customers were said to be buying less expensive merchandise and there were some pre-Christmas sales promotions at reduced prices.

Inventories at department stores probably were higher relative to sales at the start of 1954 than a year earlier. Apparel and furniture stocks were up considerably. Goods on order had been well below year-earlier totals through the fall, although stocks on hand had been appreciably larger.

Total retail sales in December were more than 2 per cent below 1952. Mail order firms reported substantially lower volume, and new car sales were by far the lowest for any month of the year.

Cautious buying resulted in a smaller than hoped for volume of new orders at the Chicago furniture show in January. Merchants appeared to believe that speedy deliveries could be counted upon in the event that reordering was necessary to accommodate spring sales.

Unskilled workers in manufacturing continued to account for the bulk of the unemployed, although openings for some skills which had been in short supply since 1950 were no longer plentiful. For various reasons factory workers do not turn easily to office

work. Unfilled requisitions for such jobs continue to be reported in most centers.

In general, Midwest manufacturing employment hit its peak last spring some months before the nation. Chicago area manufacturing employment declined from 982,000 to 960,000 between March and November. In Detroit, the number of manufacturing workers had dropped from 781,000 in July to 706,000 in November. In Milwaukee, the decline was from 209,000 in March to 193,000 in November.

Total employment in major Midwest cities held up very well in later 1953 as seasonal hirings in trade and service lines increased, and in Indianapolis an all-time high employment level was reached in the late fall. Nevertheless, unemployment insurance claims rose in all areas, and this trend was accentuated after the turn of the year.

Employers reporting to state employment services in virtually all Midwest centers indicated that they foresaw no improvement in the job situation in the next 60 days. Even in Chicago, still the tightest major labor market, relief rolls were up appreciably at year end.

Automobile firms did not produce up to expectations in December and January. Unsold stocks in the hands of dealers and manufacturers dictated layoffs by several producers in January, and indicated that the record 527,000 passenger car output scheduled for the month would not be realized. Automobile cities were also affected by the announcement that contracts for military vehicles were being scaled down and that production of these items would cease by July 1 of this year.

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Letdown in credit demand brings turnaround in bank loans to business

Business loan totals are contracting faster than usual in leading banks across the country. Only part of the 534 million dollar decline in the early weeks of the year reflects the normal seasonal turnaround in credit needs after Christmas. More significant is the underlying letdown in loan demand which has been developing since the late summer of 1953.

By the end of last year, this slackening had progressed far enough to result in the first annual decline since 1949 in business loans at reporting banks. While this decline was very small, it was nonetheless notable. It marked the end of a three-year expansion of unprecedented size—one which was touched off by the Korean outbreak in 1950, and then proceeded at a slowing pace through each succeeding year.

The first half of 1953 gave little hint of what the year as a whole was to bring. The key business loan series—commercial, industrial, and agricultural loans at reporting banks—underwent only a moderate seasonal decline in this period, with temporary interruptions due to borrowings for tax payments in March and June. By September, however, the business loan pattern of 1953 began to lag behind previous years, and in each ensuing month the gap became greater.

Major borrowers cut requests

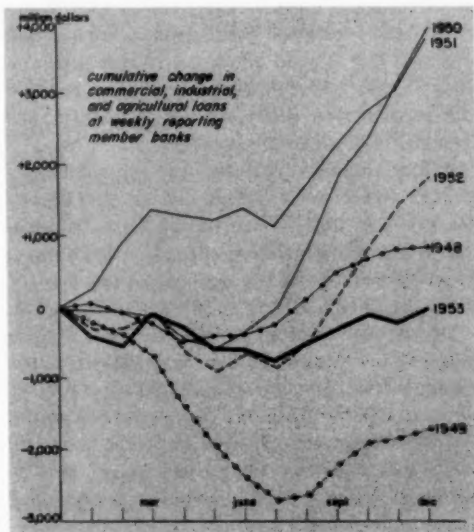
Behind the changing pattern have been the same industries which had borrowed heavily in previous falls. Loans to sales finance companies, which accounted for over 500 million dollars of the increase in the last half of 1952, decreased about 140 million in the same period last year. This was due partly to the declining momentum of consumer credit and partly to switches to borrowings from other sources.

Less dramatic but still sizable was the slow-

down in seasonal borrowings by firms handling food, liquor, and tobacco products. The autumn rise in such loans was less than two-thirds the magnitude of the preceding two years. The chief causes were lower prices for farm products and greater use by farmers of Commodity Credit Corporation price support loans, many of which lodged at least originally in rural banks. Some of these CCC credits eventually ended up in the business loan portfolios of leading city banks, but not in the form of loans to private businesses. Rather, leading banks purchased close to 400 million of special October and December offerings of certificates of interest in support loans taken over by the CCC itself.

A final major influence has been the payback of loans by metals industries. These industries were the biggest borrowers in the early stages of the post-Korea loan boom, partly because of their need for funds to execute defense contracts. They stopped borrowing in 1952, however, and actually have reduced their bank debt

Business loan growth has dwindled each year since 1950's record bulge



by some 300 million dollars since June 1953.

Even industries which are smaller users of bank credit conform with the slackening pattern. Public utilities and some oil and chemical interests had been borrowing quite steadily to help carry long-term expansion programs, yet their demands, too, are dwindling.

Over-all, the business loan trend during the past year bears a fair resemblance to movements of 1948. In these years both the spring decline and the fall rise were less than seasonal, and in each case the fourth-quarter loan increase was particularly small. If this repetition of a past pattern continues, the first half of 1954 will bring the sharpest business loan decline in five years.

As credit demand eases, interest rates show signs of softening

Reflecting some easing in the demand for credit and Federal Reserve action to loosen banks' reserve positions, several of the more "sensitive" rates have softened over the past eight months. The average yield on new issues of Treasury bills has fallen from a high of 2.4 per cent last May to about 1.2 in recent weeks. Last month, commercial paper dealers reduced the rate offered for top-grade paper for the fifth time within four months.

Many commercial borrowers are wondering if and when easier conditions in the money market will carry over to rates on business loans. The usual seasonal expansion in business loans at member banks during the last half of 1953 was much smaller than in previous years.

Moreover, several of the nation's largest banks have indicated that commitments for loans to be made in the future are substantially lower than was the case a year ago. The prime rate—the interest rate paid on large loans to large top-rated borrowers—was raised to 3¼ per cent in April 1953, which was a period of active loan demand and some credit stringency,

and has remained at that point into the new year.

Average rates on commercial and industrial loans leveled off in the third quarter of 1953 and held relatively steady through the end of the year. Barring a radical change in international affairs, this apparently marks the end of the succession of rate increases since the start of the Korean fighting.

A gradual rise

Rates on business loans have moved up in a step-like fashion since mid-1950. As the demand for funds to increase capacity and to finance payrolls swelled, average rates at large Midwest banks rose from 2.5 in September 1950 to 3 per cent in March 1951. After leveling off for six months, rates on commercial and industrial loans again moved upward, to an average of 3.5 per cent in March 1952. During the next two quarters, rates declined somewhat, reflecting a smaller volume of demand for these funds than in the two preceding years. However, a strong revival of demand for business loans in the fourth quarter of 1952 brought a further climb toward the close of the year and a continued rise until mid-1953. Since then, average rates have shown little change.

Loan rates at Midwest banks have usually followed quite closely those of other leading cities. But, in general, the average rate in this area has been slightly lower than in the U. S. as a whole (see chart). Historically, rates at East and Midwest banks have been below those on comparable loans in the West and South. Although variations have narrowed considerably in recent years, some vestige of this regional rate pattern still remains.

Rate variations

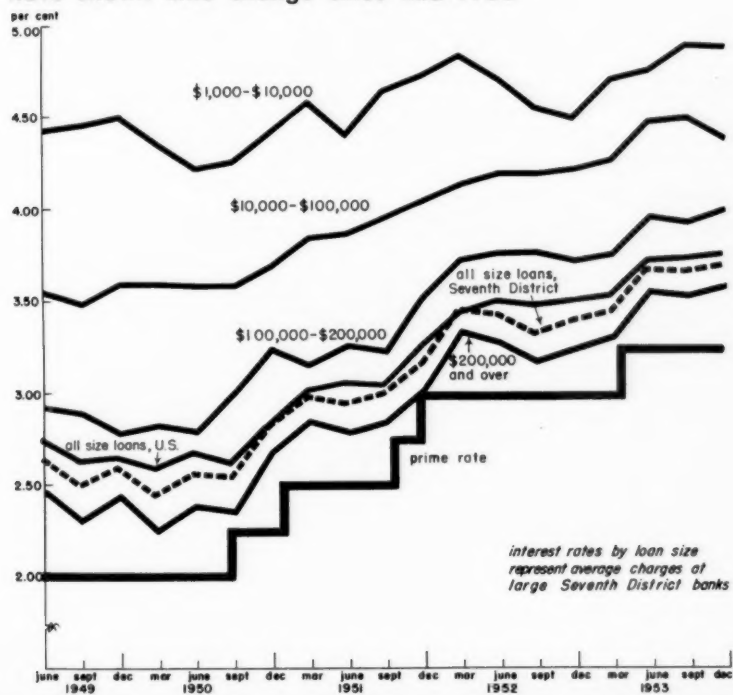
Differences in average rates among regions result also from differences in the size composition of bank loans. In general, Midwest and Eastern banks make a bigger percentage of large loans, which in the aggregate carry lower rates. New York City banks, which usually record the lowest average rates, have a higher proportion of their loan portfolios in

large loans than do banks in other major cities.

Changes in the composite rate on all commercial loans can also be influenced by such factors as the type of borrowers seeking funds at a particular time. For example, a shift in those seeking loans, from borrowers with high credit ratings to those lower on the scale, could raise the average rate, even though there may have been no change in credit conditions.

The average rate on Midwest business loans under 10 thousand dollars was 4.9 per cent at the end of 1953, over one and one-quarter percentage points above that on loans in the 200 thousand and over category. Furthermore, there is a good deal of rate variation within each size group. For example, on \$200,000-plus loans the top rate charged during December was more than three times the lowest rate.

Business loan rates at large District banks have shown little change since mid-1953



Spread narrower

The spread between average rates on the various size loans is considerably narrower now than it was in June 1950. Although rates on all sizes of loans have risen since then, rates on the biggest loans have increased most. Interest charges on borrowings of 200 thousand dollars and over have increased from 2.4 per cent in mid-1950 to 3.6 per cent at the close of last year, a rise of 50 per cent. Rates in the smallest class advanced from 4.2 to 4.9 per cent, a rise of less than 20 per cent.

This pattern of rate changes is not unusual. Rates on small loans have typically been less flexible than on large loans. Although a majority of bank loans are in these smaller amounts, the rates on such loans appear to be more

hemmed in by convention and buttressed by comparatively rigid administrative and service costs.

Since handling costs decline in importance as loan size increases, rates on loans in the largest categories would be expected to be more responsive to factors affecting the supply and demand for credit. Thus, if bank rates weaken in 1954, the large loans, as usual, will be the first to feel the effects. Despite the fact that most borrowers probably would find their rates changed, lending banks could expect a noticeable drop in that part of their income arising from interest charged to large commercial and industrial borrowers.

State-local capital spending, a prop to business?

When private spending dips, however slightly, attention naturally focuses on public agencies as potential gap-fillers. The "needs" of state and local governments are large by any criterion. Their backlog of construction requirements probably is over 100 billion dollars. So there is a common expectation that state and local capital spending will continue its steady post-1945 rise and help boost business activity in the months ahead. The trouble is that most of the money for the postwar expansion came from sources which can be further tapped only to a limited extent—war-accumulated "surpluses," state tax revenues which rose along with soaring sales and income, higher local property tax rates, and large-scale borrowing. The problem is not whether the need for public facilities is sufficient to take up the slack in private spending, but where the funds for such facilities will come from.

In order to bring construction expenditure up to its present rate, the states have drawn on

financial reserves built up earlier—from 1942 to 1947—and also have done considerable borrowing. The local units, owing to legal limits on year-to-year carry-overs, for the most part had not piled up "surpluses" during the war and early postwar period. Lacking this cushion, they have borrowed extensively and pushed up property tax rates to keep abreast of rising property values. Some have also adopted a variety of supplemental, nonproperty taxes.

Total state revenue has risen sharply since the end of the war, climbing by a steady succession of yearly increases from 6.3 billion dollars in 1946 to 13.6 billion in 1952. During this same period, however, outlay on current operations and financial aid to local governments—for noncapital purposes—jumped from 4.7 to 11.0 billion dollars, matching the swelling yields of the states' revenue systems. Expenditure on new construction can claim an even smaller portion of the state revenue dollar than was available in 1946.

Local governments' payroll expenses, which account for two-thirds of all operating expenditure, rose about 85 per cent from 1946 to 1952 or about as fast as total tax receipts.

Current revenues in the postwar boom period thus barely enabled the state and local governments to keep abreast of rising unit costs

\$120 in your pocket?

It takes about 30 billion dollars of coins and bills to meet the needs of our citizens and businesses. Some people figure this amounts to \$260 in the pockets of all those 14 years and older. But that's hardly the whole story.

Out of the 30 billion dollars, for example, about 2.8 billion is in the vaults of commercial banks—set aside, so to speak, for the use of depositors should they ask for it. Businesses, too, hold substantial amounts of currency and coins to take care of cash transactions, payrolls, and the like. At the beginning of 1953, these holdings amounted to over 5 billion dollars.

Excluding other minor nonpersonal holdings, this leaves around 21 billion of cash held by individuals. People use this money for two purposes: to cover day-to-day purchases and to "store" their reserves and savings. Nobody knows how important this "storehouse" use of money is. But if we assume that bills of \$50 and over are used largely for this purpose, we could count only coins, ones, twos, fives, tens, and twenties as money used to meet spending requirements. The amount of these denominations in the hands of individual users may be in the neighborhood of 14 billion, an average of about \$120 apiece. Is this how much you have in your wallet?

of operation and expanding work loads. The "surpluses," current borrowings, new income sources, and higher tax rates have been utilized to help support the growing volume of outlay for capital purposes.

The build-up in state funds

During the period spanning the six fiscal years from 1942 through 1947, state revenues from taxes, Federal aid, and other sources totaled 35.4 billion dollars. This exceeded by a comfortable margin expenditures of 29.4 billion. During these same six years debt retirement exceeded borrowing by 300 million dollars, so that the net accumulation from the excess of income over outgo came to 5.7 billion, an average of a little less than a billion dollars a year.

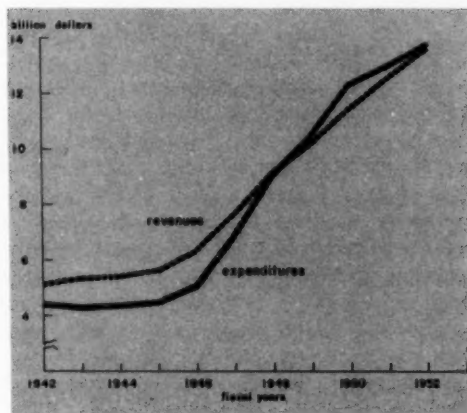
The yield of state revenue systems, which depend heavily on retail sales and income taxes, naturally rose along with prices and incomes in the 1942-47 period. Expenditures remained fairly stable through 1945, gained appreciably the next year, and spurted further in 1947. In no year, however, did expenditures reach or exceed income. Excesses of revenue over outgo were used in part to retire debt. More substantial sums, however, piled up in cash balances or were set aside in postwar reserves earmarked for use later on to help pay for maintenance and construction deferred during the war.

In the five District states, for example, aggregate balances on hand at the end of 1942 were equivalent to about five months' total expenditure. At the war's end, in 1946, accumulated balances and reserves had mounted to the point where in total they were equal to more than 10 months' expenditure at the 1946 rate and 7½ months' at 1947's rate. Experience varied widely state-to-state, as would be expected.

Spending closes the gap

Revenues in the next five years, 1948-52, amounted to 56.8 billion dollars, compared with total expenditure of 58.4 billion. The current "deficit" during this period, 1.5 billion, thus dissipated nearly a quarter of the 5.7 billion

States' income has lagged behind outgo since 1947



dollar "surplus" accumulated in the prior period. Borrowing, which had begun to play an important role in the states' financing in 1947, totaled some 5.4 billion for 1948-52, but retirements of 1.5 billion reduced net proceeds to 3.8 billion. This net borrowing, less the operating deficit of 1.5 billion, produced an addition to balances for the period of some 2.3 billion, or about 460 million a year, compared with the 1946-47 annual accumulation of just less than a billion dollars a year.

According to Census Bureau estimates, at the end of 1952 fiscal year the states owned nearly 14 billion dollars in bank deposits and securities. Only a small part of the states' financial holdings can be readily tapped—for instance there is over 5 billion dollars in retirement funds. Moreover, since nearly all state borrowing is for particular construction or veterans' aid programs, even though the funds may be on hand for months or even years, they are not available to finance new and increased capital spending.

Each year since the beginning of the war has witnessed a net addition to aggregate state balances. In the earlier years, generally through 1946, these arose out of current operating surpluses; since that time, and conspicuously from 1949 on, borrowing has been their source,

though the pattern has varied greatly. Thirteen states have come through the whole postwar period without borrowing at all, while others have relied heavily on credit.

Tax boosts ahead?

Despite all this deficit financing, state tax systems have undergone comparatively slight change in recent years. With a few exceptions, the sources of income today are taxes that had been adopted before the war. Widespread increases in the rates of cigarette and gasoline taxes have occurred, but these are taxes whose rates are stated in terms of so many cents per pack or per gallon, not 2 or 3 per cent of retail price. The rate increases have little more than kept pace with the price increases for gas and cigarettes. So, these increases are not really an exception to the general rule.

To some extent, the limited tax revisions in recent years reflect a policy of "wait-and-see." One after another of the gubernatorial budget messages and later expenditure policy statements, however, have drawn attention to the failure of expected income fully to balance outgo and, in defining the role to be played by reserves, warn of an approaching day of reckoning. If experience bears out budget ex-

pectations, reserves soon will be no larger, relative to today's expenditure levels, than before World War II, when reserves were considered working balances, not a way to meet biennial deficits. As a matter of fact, the 1942 relationship between balances and spending had been restored by the end of 1952 in the District states, taking them as a group. In the near future, therefore, many state officials and legislators may be proposing new taxes, tax-rate increases, and base modifications.

The search for local revenue

Some further increases in property taxes, major source of local income, undoubtedly are in store, but for a number of reasons they are likely to prove as incomplete a solution as they are unpopular. A widespread conviction that property can bear no more than its present load, cumbersome legal provisions governing tax rates, the tardy response of assessments to property value, and competitive pressure of low-tax areas, as well as the long lag between levy and collection, are among deterrents to greater reliance upon the *ad valorem* tax as a source of needed additional income.

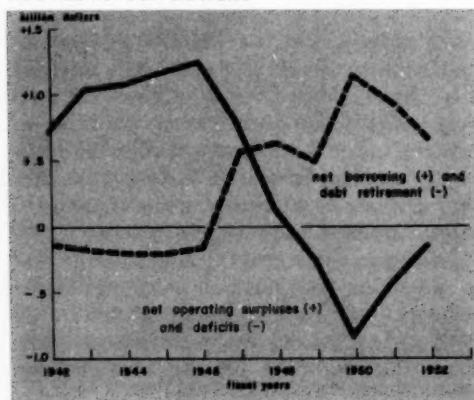
Non-property taxes

The move to local taxes upon bases other than property has gathered momentum in recent years. A variety of new levies adopted by Pennsylvania municipalities, the income and payroll taxes found in 30 or more of the larger cities, local sales taxes adopted since 1945 by 163 municipalities in California, and Chicago's new cigarette tax all are examples.

Often difficult and costly to administer, many of these new levies have proved unpopular with taxpayers, and there is considerable resistance to their spread. Such levies, for all the local governments utilizing them in 1952, yielded 627 million dollars, unimposing alongside the 8.3 billion in property tax revenue.

One of the most promising possible sources of the additional income that local governments urgently need in order to finance their construction programs is further exploitation of user charges and taxes. These are means of

States' debt payment partly offset surpluses; borrowing has covered deficits



recovering the cost of services rendered by charging fees proportional to use or benefit.

Construction and maintenance of highways and streets is a good example of the kind of public expenditure that can be paid for in this way—via tolls, local shares in state-collected fuel taxes, special assessments levied upon benefited property, and the like. Sewage disposal, water supply, airport, and transit facilities similarly can be acquired or built and operated at the expense of those using them. More widespread adoption of this device offers promise as a way of unburdening present general tax sources of a part of the load they now support.

On the other hand, some of the most important types of government expenditure—for schools, welfare and health purposes, police and fire protection, for example—are usually regarded as charges properly borne by the whole community. Although the possibility of doing so is receiving increasing attention, seldom has it proved feasible to equate price and benefit to *individual* "users" of this type of local-state services. To the extent that user taxes and charges can take over the burden of services for which price and benefit can be calculated on an individual basis, there will be more property tax money and local borrowing capacity available for schools, public safety, and health and welfare programs.

Can state-local spending help?

Regardless of the need for more state-local facilities and more funds for the operation of existing ones, state-local expenditure must be tailored to the resources currently at hand to pay for it.

Fiscal resources now on hand or in view at the present time will support a rise in combined state and local expenditure during the near-term future, but if this trend is to continue for long, more revenue will be needed. Even present spending plans have assumed, moreover, that business activity will hold to something like its recent level. Since the states depend so much on sales and income taxes, which are sensitive to the course of business, a setback of any but the mildest sort probably would result

in a downward adjustment in spending from state and local sources of revenue. Since construction activity can be postponed more easily than current operations can be cut back, capital spending would be affected most.

State and local governments behave much as businesses and individuals. They retrench when their income drops in bad times, and they lay bold plans in good times. They therefore do not help appreciably in the job of countering upward and downward swings in business activity. But they differ from private spenders in that their securities become relatively more attractive as less promising private investments become less attractive. The trouble is that declining sales, income, and property tax revenues make the states and cities afraid of borrowing for new projects. To the extent, however, that new projects to be financed by their users give evidence of being in demand despite receding private business activity, revenue bonds would have an ideal market. So, more user financing and more revenue bonds offer the one way that state and local agencies can help offset even a dragged out setback from their own resources, with a minimum of Federal Government props.

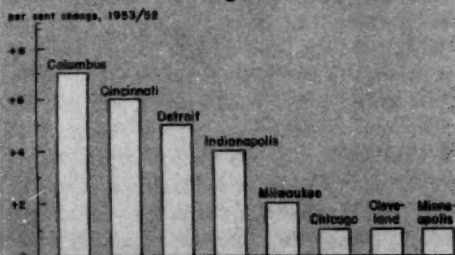
IN STORES AND FACTORIES

Midwest shows greater department store sales gain than other areas in 1953

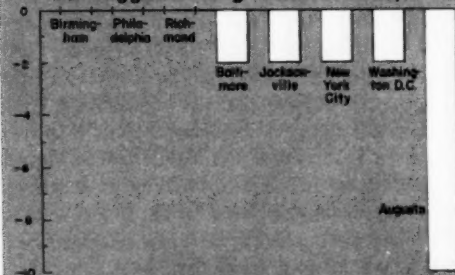
Department store sales in principal Midwest cities generally showed larger 1953 gains than did sales in the principal cities of any other major region. Topping the list were cities in which metal fabricating industries predominate. A large output of automobiles, along with high-level activity in related defense lines, set the stage for the 5 per cent gain over 1952 in Detroit and the 4 per cent gain in Indianapolis. Sales also exceeded the year-ago volume in most other large Midwest cities.

Along the East coast, the largest cities registered declines. In New York City, department

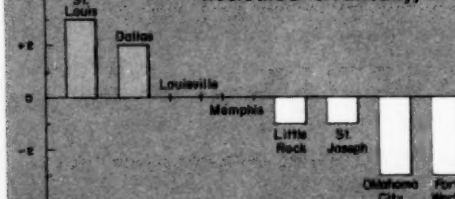
Department store sales in major Midwest cities gained over 1952



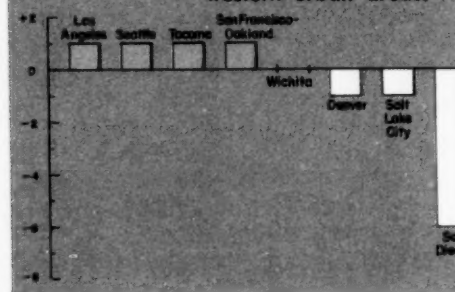
but lagged in big eastern cities,



while sales in southern towns fluctuated erratically,



as was the case in major western urban areas.



store sales lagged throughout the year, although increases were scored upstate in Buffalo, Rochester, and Syracuse. The photoengraver strike that held up advertising campaigns for several weeks before Christmas may have been a contributing factor. Declines were also recorded in Washington and Baltimore, probably reflecting the move to reduce Government employment. For the entire area between the New England states and Georgia, 1953 sales were less than in the previous year.

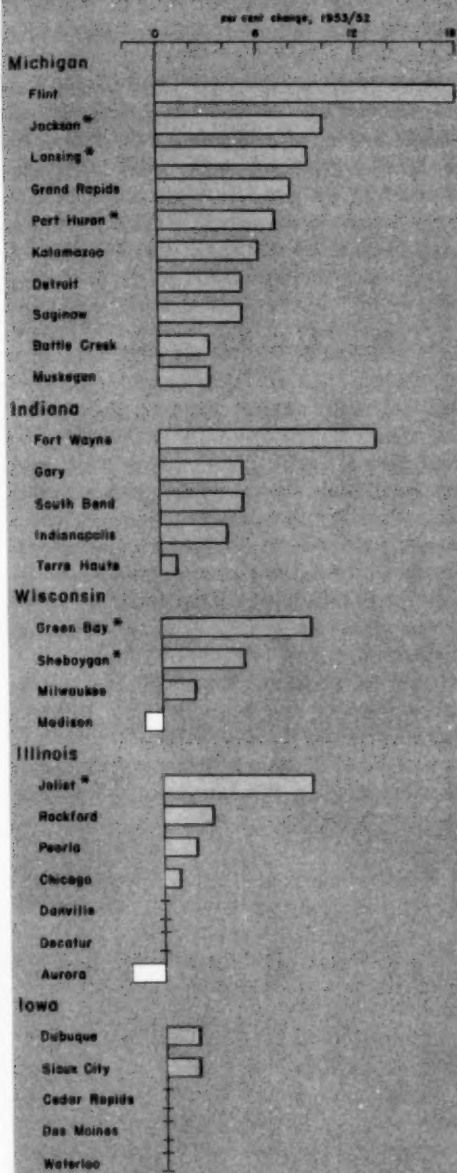
Many cities in the southern states also failed to match their year-earlier volume. Sales were down in Little Rock, St. Joseph, Oklahoma City, and Fort Worth, and as a region the South was only slightly better than in 1952.

In the western half of the United States, the experience of major cities also showed variations, but sales for the region barely equaled those of last year. This marks the first time in four years that department store sales in the West have failed to gain by around 5 per cent over the preceding year.

It was the booming activity in industries which provide important amounts of employment in Mid-America that set the stage for the favorable showing of department stores last year. The sales gains in these centers, together with those in the smaller centers in surrounding areas, contributed heavily to the national gain of 2 per cent in 1953 sales.

When Midwest cities are ranked in the order of their sales increase, a rough pattern emerges. Twenty-six of the 33 District cities that report department store sales chalked up gains over 1952. The largest increases were recorded for cities in predominantly industrial areas such as the auto-producing regions in Michigan. Detroit's 5 per cent gain not only led the principal cities of the District, but compared favorably with other leading cities throughout the entire nation. Of all the District centers, however, Flint, another auto city, led the pack with a whopping 18 per cent gain over 1952. The centers which showed little or no gain in sales tended to be located in agricultural areas. Reduced farm income was probably the chief contributing factor.

Industrial cities lead Seventh District in department store sales



* January through November only.

Although department store sales include a wide range of merchandise, they do not disclose the complete picture of retail trade. There are no department stores in many of the smaller towns. Furthermore, certain important items are not customarily sold in department stores. This is true of automobiles and accessories and, to an even larger extent, of food which is handled by only a very few of the large stores. Lines sold by department stores are also distributed through competitive specialty outlets; particularly is this the case with the durable goods such as furniture, radios, and television. Nevertheless, the trend in department store sales is followed closely for any clues it may give of the trend in over-all retail trade.

Small annual gains in department store sales have been recorded in each of the last two years. The year-to-year comparisons, however, fail to reveal a significant development. The two years, for example, break conveniently into three periods. The first half of 1952 was quite unspectacular but was followed by an upsurge in sales in the second half which extended through the first half of 1953. Since then sales have proceeded at a rather lethargic pace. Thus, while department store business was excellent for 1953 as a whole, it tended to weaken as industrial production and employment declined in the metal industries in the second half of the year.

Hard goods spark four-year industrial expansion

Last year the output of American factories and mines topped 1952, the previous record year, by 8 per cent. The average production rate for 1947-49, a period before the outbreak of Korean hostilities, was exceeded by one-third. This high level of output overshot the requirements of final buyers in most lines. As a result, inventories piled up, and in mid-1953

total production began to sag noticeably for the first time in four years.

The gain in industrial output, together with the gradual recession from the peaks of last spring and summer, is documented by the newly revised Federal Reserve Index of Industrial Production. These data show with improved accuracy the impact of the upsurge of military and civilian demand in the past few years upon the volume and pattern of production. They also illuminate the especially rapid growth of production in the Midwest prior to the middle of 1953 as well as the subsequent adjustment from peak levels in this region. As is common for most widely used economic indicators, the new industrial production index uses the average of the years 1947-49 as a base period equal to 100.

Durables dominant in Midwest

More than 70 per cent of the gain in industrial output between 1947-49 and 1953 was accounted for by durable goods. These "hardware" items include business investment purchases of machinery and equipment as well as consumer durables such as automobiles, furniture, and appliances. Virtually all production categories showed substantial increases, but the amount varied greatly for individual industry groups. Soft goods lines such as the food, textile, and leather groups, for example, managed only a 10 per cent rise. Increases in metals lines were generally much greater. The rapid expansion of durable goods output was due to: (1) the defense effort—aircraft, for example, showed a fivefold increase; (2) the high rate of business investment—machinery of all types rose by about 75 per cent; and (3) the heavy demand for consumer hard goods—output of cars, appliances, and furniture all showed impressive gains.

The pattern of growth in factory output was responsible for the extremely prosperous conditions which prevailed in Midwest centers through most of last year. About three-fourths of manufacturing employment in Illinois, Indiana, Iowa, Michigan, and Wisconsin during 1953 was in durables, compared with 58

per cent in the nation. This region includes two-thirds of automotive industry employment, three-fourths of the farm implement workers, and a large proportion of all industrial machinery and electrical goods employment. (See chart on back page.)

Metal-using industries expanded output with great rapidity between the base years and 1953. Whereas industrial production over-all rose 34 per cent during this period, metal fabricating increased by 68 per cent. About 35 per cent of the nation's employment in these lines is in District states, whereas these states account for 22 per cent of all manufacturing employment and only 16 per cent of the nation's population.

Durables vulnerable in decline

During the period from May to August of 1953 output of durable goods factories hit a level which exceeded the 1947-49 average by about 56 per cent. By November these lines were down 6 per cent from the peak rate on a seasonally adjusted basis, and the decline appeared to be continuing. The drop reflected a topping out of defense procurement and business capital expenditure programs and moves to work down large inventories of consumer durables.

Capital expenditures have long been recognized as one of the more unstable segments of total spending. Business expansion tends to alternate between periods of great sluggishness and strong activity. The variability of consumer expenditures for durable goods also contributes to instability, and this factor has become increasingly important as the proportion of income directed to such purchases has risen.

Investment buying of business and purchases of automobiles and furniture by consumers would tend toward instability even in the absence of a change in income levels. When profits and personal income decline, expenditures of this type are quite likely to come under the ax in individual budgets. Expansion is less necessary under these circumstances, and consumers are inclined to postpone large purchases. The larger the share of consumer income going to durables, the greater the simi-

larity of consumer spending to business investment decisions is likely to be.

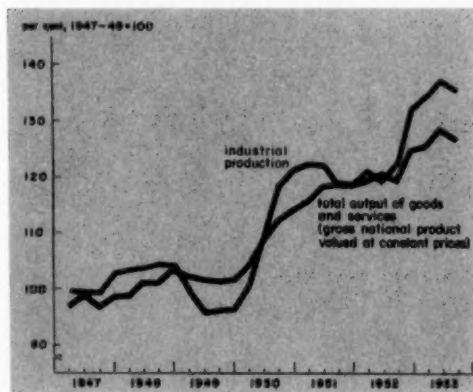
Measuring production trends

For many years the Federal Reserve Index of Industrial Production has been widely used as a measure of business activity and a tool for the analysis of industrial fluctuations. The index shows the course of all mining and manufacturing output in a fashion which permits comparison of particular periods. It does not include construction activity or the contributions of farms, trade firms, utilities and other services, or governmental bodies.

Manufacturing and mining output varies more widely and more abruptly during fluctuations in business activity than does total output. Thus, the industrial production index shows wider swings than the broader measures, especially those more heavily weighted with soft goods and services (see chart). Moreover, industrial production provides the backbone for a modern society, and output of factories and mines can be computed readily on a physical rather than a dollar volume basis. Primarily for these reasons the FRB index stands high in usefulness among the economic indicators.

The index of industrial production must be

Industrial production fluctuates relatively more than total output of goods and services



modernized periodically if it is to maintain its usefulness. The most obvious change made in the index in the recent revision was the shift in base period from 1935-39 to 1947-49. This change is merely intended to provide a more convenient reference point. It has nothing directly to do with the accuracy of the data.

The important changes in the index, all of which contribute to its reliability, are (1) the use of a larger number of basic series for particular commodities, which had not been represented directly heretofore, (2) the use of post-war weights to measure the relative importance of each industrial group, and (3) the introduction of new seasonal adjustments.

The new monthly index is being compiled from 175 separate series as compared with about 100 in the past. Moreover, a yearly index based upon 1400 series will also be issued. Monthly series will be adjusted to yearly data.

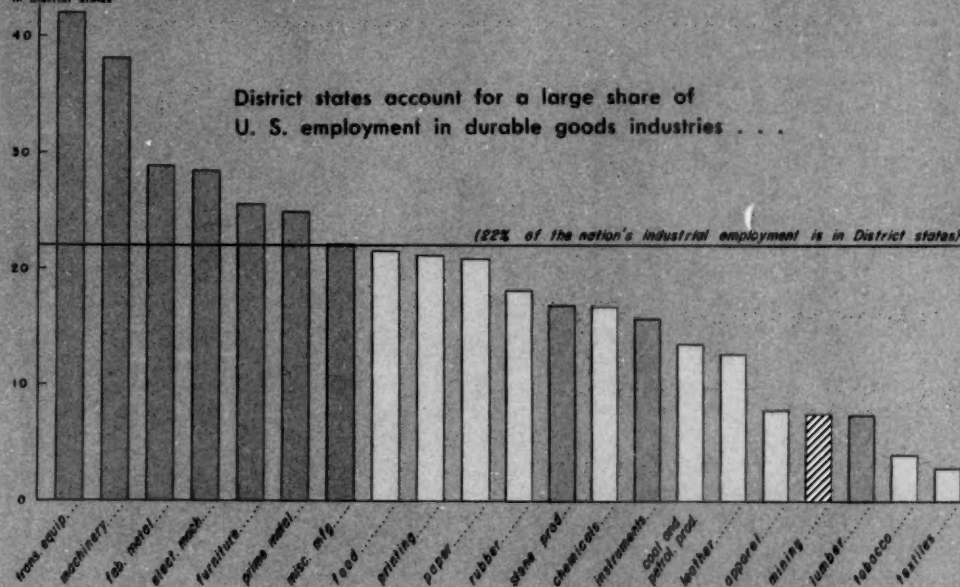
The necessity of using new weights arises from the fact that changes occur in the composition of industrial production over a period of years. Durable goods as a whole now constitute a substantially larger proportion of total activity than in the Thirties. Transportation equipment alone has been increased from 6 to 7½ per cent. Nondurable goods have declined in importance, but certain segments of this grouping, particularly chemicals have been raised. Minerals have been reduced from 15 to 10 per cent.

Seasonal adjustments have also been brought up to date on the basis of experience of recent years. Previously, for example, an inadequate allowance had been made for summer vacations, and the adjusted index usually dropped sharply in July in a manner which did not reflect underlying trends.

The heavier weight given to production of durables, coupled with the fact that these industries have expanded most rapidly in the postwar period, has caused the new index to show total output growth in this period to have exceeded earlier estimates. Any change in the production pace in hard goods lines also will be reflected more fully in the new than in the old index.

Industries heavily concentrated in the Midwest have shown large output gains in recent years

per cent of U.S. employment in District states



per cent increase in production, 1947-49 to 1953

